

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT****Office of the Secretary**

[Docket No. FR-3924-N-01]

**Notice of Operating Cost Adjustment
Factors for Low-Income Housing
Preservation and Resident
Homeownership Projects Assisted
With Section 8 Rental Payments****AGENCY:** Office of the Secretary, HUD.**ACTION:** Notice.

SUMMARY: The Low-Income Housing Preservation and Resident Homeownership Act of 1990 ("LIHPHA") requires that future rent adjustments for LIHPHA projects be made by applying an annual factor to be determined by the Secretary to the portion of rent attributable to operating expenses for the project and, where the owner is a priority purchaser, to the portion of rent attributable to project oversight costs. This notice announces Operating Cost Adjustment Factors ("OCAF(s)"), to be used for rent increases under LIHPHA, which are based on a formula using data from the Bureau of Labor Statistics that measure changes in wages and the costs of non-food consumer goods. The most recent published OCAF will be applied on the anniversary date of the housing assistance payments contract. An explanation of the methodology employed to develop the OCAFs is set forth below.

EFFECTIVE DATE: June 1, 1995

FOR FURTHER INFORMATION CONTACT: Barbara Hunter, Acting Director, Planning and Procedures Division, Office of Multifamily Housing Management, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; telephone (202) 708-3944; (TDD) (202) 708-4594. (These are not toll-free numbers.)

SUPPLEMENTARY INFORMATION:**OCAFS**

The Low-Income Housing Preservation and Resident Homeownership Act of 1990 ("LIHPHA") (see, in particular section 222(a)(2)(G) of LIHPHA 12 U.S.C. 4112(a)(2)(G) and the regulations at 24 C.F.R. 248.145(a)(9)) require that future rent adjustments for LIHPHA projects be made by applying an annual factor to be determined by the Secretary to the portion of project rent attributable to operating expenses for the project and, where the owner is a priority purchaser, to the portion of project rent attributable

to project oversight costs. The Secretary has determined to use the OCAF as the annual factor.

**Budget-Based Method of Calculating
Contract Rent Increases**

If an owner believes that the contract rents approved by the Secretary pursuant to the OCAF are not adequate, an owner may request that its contract rent increase be calculated using the budget-based method. Owners shall: (1) Submit documentation to HUD pursuant to the procedures in Chapter 7 of HUD Handbook 4350.1. Insured Project Servicing Handbook, and (2) demonstrate that an increase in contract rents above that provided by the OCAF are necessary to reflect extraordinary necessary expenses of owning and maintaining the Housing. If the Secretary determines that the project rents pursuant to the OCAF are insufficient to cover project operating expenses, the Secretary may increase contract rents in excess of the amount determined pursuant to the OCAF to reflect extraordinary necessary expenses of owning and maintaining the project. Any contract rent increase resulting from using the budget-based method shall be effective for the year approved.

Method for Calculating OCAF

In seeking to find the best operating cost adjustment factors for this purpose, the Department analyzed several sources of data. HUD's own data on rental project operating costs formed the largest and most reliable set of time-series data on actual project expenses. Bureau of Labor Statistics (BLS) data on wages and prices were found to offer the most reliable surrogate data sources.

After exploring alternative approaches, two methods of developing OCAFs were considered for detailed review. One was to use administrative and operating expense data for unsubsidized FHA-insured projects as the basis for developing factors. The other was to use BLS data on wages and prices as a surrogate indicator of operating cost changes.

An analysis of the HUD FHA data from the Form HUD-92410 showed that utility, tax, and insurance expenses had such a high degree of variability that measurements of area- or regional-level average or median expense changes had little relevance to most projects, and that these data could not be used to provide meaningful measures of change. Analysis efforts were therefore concentrated on the "Administrative" and "Operating and Maintenance" expense items reported on the HUD 92410. It was found that a large percentage of FHA-insured, unassisted

projects had unusual changes in year-to-year administrative and operating costs, possibly due to expensing of major repairs using reserve funds that are transferred into the operating expense account. This is of concern, since using operating expense change factors that partly reflect unspecified inclusions of reserve expenditures means that the data do not provide a good indicator of normal, on-going operating expenses or of changes in those expenses. This also appears to explain why change factors developed using FHA-insured administrative and operating expense data do not have a significant central grouping tendency, but instead are spread relatively evenly over a wide range of values. Use of an average or median value has less meaning in such situations than it normally does, since only a few projects have values near the average.

Starting in 1993, HUD began to collect more detailed budget information for all FHA-insured projects, including information on funds transferred from project reserves to cover work reported as operating and maintenance expenses. In future years, this information may make it feasible to develop reliable OCAFs based on costs incurred by unassisted, FHA-insured projects. The Department intends to re-examine the feasibility of this approach as more data become available, but believes that actual operating expense data are not a reliable basis for developing OCAFs at this time and does not intend to use these data to calculate OCAFs.

The second option studied takes advantage of the fact that nearly all administrative and operating expenses are either labor-related or are tied to the cost of non-food producer goods. Labor-related costs should normally tend to move with regional changes in wages, while the cost of most producer goods should change in a similar manner throughout the country. The cost of changes in goods used in administrative and maintenance work can be measured by the BLS Producer Price Index. Wage and employment data are collected on a comprehensive and highly reliable basis by the Bureau of Labor Statistics (BLS). HUD uses BLS wage data in calculating median family income levels, and it uses BLS government wage data as the main determinant of the annual increases for Public Housing Allowed Expense Levels.

Research on Public Housing program administrative and operating expenses has shown that approximately 60 percent of such expenses are labor-related and 40 percent are tied to purchased goods. Since 1983 HUD has used this 60-percent-wage/40-percent-

price-index ratio to update Public Housing Allowed Operating Expenses. The approach has been the subject of research and has been found to work well. It was used to develop OCAF factors that measure changes in "Administrative" and "Operating and Maintenance" expenses, as follows:

OCAF = (60% * BLS private sector wage change + 40% * BLS non-food PPI change) * (avg. operating and maintenance costs / avg. non-debt service costs)

The FY 1995 OCAF figures, shown on the accompanying appendix, were produced for the metropolitan and nonmetropolitan area parts of each of the ten HUD Regions using the BLS data from the final annual ES-202 series data on employment and wages. This is the same level of geography used for Section 8 Annual Adjustment Factors (AAFs), and has the advantage of capturing regional economic trends while avoiding the sometimes erratic

changes that would result from use of more localized data. Future OCAF factors will be released on an annual basis.

Dated: July 17, 1995.

Henry G. Cisneros,
Secretary.

Appendix

LOW INCOME HOUSING PRESERVATION AND RESIDENT HOMEOWNERSHIP ACT OF 1990—FY 1995 OPERATING COST ADJUSTMENT FACTORS

HUD re- gion	Area	Total	Metro	Nonmetro
1	New England	2.3%	2.3%	1.9%
2	New York-New Jersey	3.2%	3.2%	1.6%
3	Mid-Atlantic	2.2%	2.2%	1.9%
4	Southeast	2.3%	2.3%	2.3%
5	Midwest	2.2%	2.3%	1.9%
6	Southwest	2.1%	2.1%	1.6%
7	Great Plains	2.1%	2.2%	2.0%
8	Rocky Mountains	1.9%	2.0%	1.7%
9	Pacific/Hawaii	0.7%	0.8%	1.4%
10	Northwest/Alaska	2.4%	2.6%	1.6%
	U.S. Total	2.0%	2.1%	1.9%